RAILWAY CONVENTION COMMITTEE
1954

REPORT

LOK SABHA SECRETARIAT
NEW DELHI
November, 1954

Committee on Separation of Railway Finance from General Finance, 1954

Chairman

Shri M. Ananthasayanam Ayyangar.

Members

2. Shri C. D. Deshmukh.
3. Shri Lal Bahadur Shastri.
4. Shri R. Venkataraman.
5. Shri Basanta Kumar Das.
6. Shri Satyendra Narayan Sinha.
7. Shri Nageshwar Prasad Sinha.
8. Shri Narendra P. Nathwani.
9. Shri Ram Saran.
10. Shri B. Ramachandra Reddi.
11. Sardar Lal Singh.
12. Shri Tulsidas Kilachand.
13. Shri K. Ananda Nambiar.
14. Shri R. M. Deshmukh.
15. Shri B. C. Ghose.
16. Babu Gopinath Singh.
17. Shri T. V. Kamalaswamy.
18. Shri V. M. Obaidullah Sahib.

SECRETARIAT

Shri S. L. Shakdher—*Joint Secretary.*

Shri V. Subramanian—*Deputy Secretary.*

CONTENTS

Appendix

I

Introduction

I, the Chairman of the Railway Convention Committee, 1954, having been authorised by the Committee to present the report on their behalf, present this Report.

2. The current financial year is the fifth and final year of the 1949 Convention. The Convention Resolution of 1949, which was passed by the Constituent Assembly of India (Legislative) on the 21st December, 1949, *inter alia* laid down that a Committee of the House should review the rate of dividend towards the end of the aforesaid period and suggest for the years following it, any adjustment considered necessary, having regard to the revenue returns of the Undertaking, the average borrowing rate of the Government and any other relevant factors. A Committee of both Houses of Parliament was accordingly constituted in pursuance of the following Resolution adopted by the Lok Sabha on the 12th May, 1954 and concurred in by the Rajya Sabha on the 14th May, 1954:—

"That this House resolves that—

(i) A Parliamentary Committee consisting of twelve members of this House to be nominated by the Speaker be appointed to review the rate of dividend which is at present payable by the Railway Undertaking to the General Revenues as well as other ancillary matters in connection with the separation of Railway Finance from General Finance, and make recommendations thereon by the 30th November, 1954; and

(ii) that this House recommends to the Council of States to agree to associate six members from the Council with the Committee and to communicate the names of the members so appointed to this House".

3. The first sitting of the Committee was held on the 1st October, 1954. At this sitting the Committee drew up the undermentioned list of subjects which they liked to take up for detailed investigation with reference to the above Resolution and asked the Railway Board to furnish detailed memoranda:

"(i) the future financial prospects of the Railway Undertaking on the basis of the present rates and fares;

(ii) the average borrowing rate of Government in the recent past;

(iii) whether it will be desirable to have an amortisation fund, and, if so, what should be the contribution to the Fund having regard to the actual contribution to General Revenues;

(iv) the rate at which contribution to the Depreciation Reserve Fund should be made to ensure that adequate funds are available for renewals and replacements of Railway assets;

(v) the needs of the Development Fund to meet the demands for amenities to users of the Railways, for welfare schemes for Railway staff, for unremunerative developmental work, etc.;

(vi) the rate of growth of the Railway Capital-at-charge and ways and means of financing such expenditure; and

(vii) the appropriate size of the Revenue Reserve Fund and the demands that may be made upon it.

(viii) New Lines: Should any special concession in regard to payment of dividend be given to Capital invested on new lines so as to encourage the undertaking of the construction of such lines for development purposes?

(ix) Whether test of remunerativeness of a Project requires revision in the light of the result of the review of the dividend payable?

(x) Whether any alterations in the Rules of Allocation of Railway expenditure introduced in 1950 as between Capital, Revenue and Development Fund are considered necessary in the light of the actual working during the last four years?

(xi) Whether the rate of dividend of 4 per cent. on the Capital-at-charge payable to General Revenues requires to be revised, and if so, what should be the revised rate and how it should be met by the Railways.

(xii) In the event of any difficulty in fixing a new rate of dividend, whether alternative methods of contribution to General Revenues, *e.g.*,

(a) a small fixed percentage on the Capital-at-charge, plus sharing of profits after payment of interest,

or

(b) Interest on Capital, plus a levy of Income-tax as on other Government Undertakings together with or without any contribution for investment, fixed or varying,

may not be resorted to ?

(xiii) Whether the element of over-capitalization in the Loan Capital should be eliminated in keeping with sound commercial practice, and if so, to what extent, and how?

(xiv) Whether any alternative method of financing unremunerative development work is feasible if adequate resources are not available in the Development Fund?"

The Committee also directed the Financial Commissioner, Railways to submit to them a Review on the lines of the one prepared by his predecessor at the time of revision of the Railway Convention in 1949.

4. The Committee reassembled on the 12th and continued on the 13th and 15th November, 1954 to consider the memoranda submitted to them by the Railway Board and the Financial Commissioner's Review. The Committee after reviewing the future financial prospects of the Railway Undertaking and the pattern of relationship between the Railway and General Finance for the next five years as presented through the memoranda submitted by the Railway Board formulated their conclusions which are set forth in Part II of this Report.

5. A statement showing the summary of the principal recommendations of the Committee is also appended to the Report (Appendix I).

6. The Committee wish to place on record their great appreciation of the valuable assistance rendered to them in the course of their deliberations by the Railway Board and the Financial Commissioner Railways and their staff and also the Lok Sabha Secretariat.

Review of the Separation Convention of 1924 as revised in 1949

7. Railway Finance was separated from General Finance, primarily to secure stability for Civil estimates by providing for an assured contribution from Railway Revenues and also to introduce flexibility in the administration of Railway Finance in pursuance of a Resolution adopted by the Legislative Assembly on the 20th September, 1924. The most notable features of the 'Separation Convention' were, firstly, the fixation of an annual contribution from Railways to General Revenues calculated with reference to the Capital-at-charge of the Railway system and the profits earned by it and secondly, the establishment of a Reserve Fund and a Depreciation Fund for Railways.

8. The various Committees, which have from time to time reviewed the working of the Separation Convention since 1924, have been unanimously of the opinion that the basic principles underlying the separation of Railway Finance from General Finance were sound and calculated to promote the interests of both and should not be disturbed. The Convention Committee of 1949 also confirmed the desirability of keeping Railway Finance separate from General Finance on the same basis, but they felt that the twin targets of the Separation Convention of 1924 had not been completely fulfilled. On the one hand, the contribution payable under the 1924 Convention as well as under the modified Convention of 1943, being an indeterminate amount dependent on the volume of the Railway Revenue surplus in individual years, did not free the Civil Budget completely from the fluctuations in the Railway Finance, on the other, it did not afford an opportunity to the Railways to build up adequate reserves in years of prosperity for ensuring at least a minimum return to General Revenues in years of depression when the need for assistance was greatest, and undertaking expansion of Railway facilities, improving the standard of service rendered or the amenities provided for the staff. Considering the relative requirements of Railways and General Finance, the Convention Committee of 1949 came to the conclusion that the contribution by the Railways to General Finance should take the shape of a fixed dividend of 4 per cent. on the Capital-at-charge as computed annually for a period of 5 years from 1950-51. This according to the Review of the Financial Commissioner for Railways 'has ensured a steady income to the General Revenues for the period and would also enable the Railways to credit to reserve sums amounting to Rs. 72 crores for discharging their obligations towards rehabilitation, increasing operating efficiency and provision of adequate amenities'.

9. The Convention Committee of 1949 laid down the following measures to arrest the over-capitalisation of the Railway Undertaking:

(i) that all unremunerative new lines and works such as passenger amenities, staff quarters of the lowest category, operating improvement works above a certain monetary limit (Rs. 3 lakhs) should be charged to Development Fund created out of revenues for this purpose;

(ii) that the cost of all replacements including the inflationary and improvement elements should be charged to the Depreciation Reserve Fund instead of partly to Capital and partly to Depreciation Reserve Fund as had been the practice in the past; and

(iii) that the New Minor Works limit should be raised from Rs. 10,000 to Rs. 25,000/-.

10. The following specific suggestions have been made by the present Financial Commissioner Railways in his Review for the consideration of the Committee.

I. (a) That the entire expenditure (and not the excess over Rs. 3 lakhs only) on operating improvement works not directly remunerative, costing more than Rs. 3 lakhs each, should be debited to Development Fund.

(b) That the replacement cost of assets created out of Development Fund should also be met from the Depreciation Reserve Fund.

(c) That, although under the Convention of 1949, the cost of quarters of the lowest category, *i.e.*, of Class IV staff only, is charged to Development Fund, as all quarters are unremunerative, all quarters other than those for gazetted staff should be charged to the Development Fund.

II. New Lines. The cost of all new lines when decided to be constructed, in future, might be charged to Capital from the very beginning. A moratorium should be granted to the Railways on the dividend payable upto the end of the fifth year of the opening of new lines.

III. The present practice of paying the contribution through a fixed rate of dividend, inclusive of interest charges, need not be disturbed.

IV. Considering the fact that the average borrowing rate is on the upward trend and its present level (3·17%) is comparable with that (3·18%) obtaining in 1949-50 when

the present rate of dividend of 4 per cent. was fixed, the present rate of dividend to General Revenues should remain unaltered but the contribution should be calculated on the total Capital-at-charge as computed annually after taking into account the moratorium on the outlay on New Lines.

11. The Committee now proceed to deal with the various issues raised in the above recommendations made by the Financial Commissioner for Railways and the Memoranda furnished by the Railway Board.

Rate of Dividend

12. The Committee first took up for consideration the most important issue, *viz.*, the dividend payable by Railways to General Revenues, its form and quantum. While discussing this issue, a fundamental question was raised regarding the nature of the Railway Undertaking. On the one hand, it was urged that the Railways should be treated as purely a Commercial concern and that General Revenues, as the sole owner of the Undertaking, should be paid a fair return on the Capital invested. On the contrary, it was held that the Railways ought to be treated as a purely public utility concern with no profit motive and that the minimum rate of interest alone should be chargeable on the Capital invested. The Committee considered both the aspects and came to the conclusion that the Railways ought not be treated either purely as a Commercial concern or as a Public Utility Service without any return on the investment. A balance has to be struck between these two aspects. Therefore, treating it as both a Public utility and Commercial concern, the Committee addressed themselves to the nature and quantum of contribution.

13. The Committee then explored whether any of the following alternative methods of contribution to General Revenues in the event of any difficulty in fixing a new rate of dividend might be resorted to:—

(i) A small fixed percentage on the Capital-at-charge *plus* sharing of profits after payment of interest;

(ii) Interest on capital *plus* a levy of Income-tax together with or without any contribution, fixed or varying.

The first alternative will introduce an element of uncertainty in the General Revenues which it was the purpose of the 1949 Convention to avoid. As for the second alternative, the quantum of Income-tax payable would depend on the size of the taxable surplus and the rates of Income-tax in force from time to time and will thus be fluctuating. Besides, it was also pointed out by the

Railway Board that it would be difficult to compute the depreciation allowance under the existing Railway Accounting system, in accordance with the provisions of the Income-tax Act. Elaborate accounts of individual assets involving much avoidable labour might have to be maintained which would mean a complete overhauling of the Accounting structure. The Committee are not in favour of effecting such radical changes in the structure of the Railway Accounts. A suggestion was put forward in this regard that the Capital-at-charge of the Undertaking should be separated into Loan Capital and Equity or Block Capital and the Railways should be called upon to pay interest on the Loan Capital, while the Equity Capital will participate in the surplus profits of the Undertaking, if any, half and half. The Committee feel that this method of contribution would also suffer from the same drawback as the first alternative above. It would mean putting the clock back and defeat the very object of the Separation Convention of 1924 to keep free the General Finance from the vicissitudes of the Railway Revenues.

After careful consideration, the Committee came to the conclusion that either of these suggestions would not be feasible and it would be advantageous from all points of view to express the rate of dividend in terms of a percentage on the Capital-at-charge and the amount paid annually through a fixed rate of dividend inclusive of the element of interest.

14. The question then arises as to what should be the rate. The 1949 Convention recommended that the payment to General Revenues should take the shape of a fixed dividend of 4 per cent. for a period of 5 years on the Capital invested as computed annually. A review of the financial prospects of the Railway Undertaking for the next five years on the basis of the present rates and fares furnished by the Railway Board disclosed that if the Railways were to continue to pay dividend at 4 per cent. during the next five years after meeting all working expenses and providing adequate contribution to the Depreciation Reserve Fund, there would be a short-fall of Rs. 31 crores during that period. This short-fall, the Railway Board hope, could be made up partly by a moratorium in respect of the payment of dividend to the General Revenues on new lines during the development stage and partly by minor adjustments in fares and freights without having recourse to a general increase in them. They, however, stated that this would leave no funds to be appropriated to the Development Fund for financing development expenditure during the next five years unless the tariff rates were raised generally or the quantum of the dividend liability was substantially reduced by bringing down the rate of dividend.

15. The Committee note that during the five years from 1950-51 to 1954-55, a sum of Rs. 7 crores per annum on an average has been paid by the Railways to the General Revenues by way of contribution over and above the interest charges on the total Capital-at-charge. General Revenues will require funds for financing the Second Five Year Plan which includes a substantial sum for the expansion of Railway also. Any curtailment of the resources available to General Revenues at this juncture would affect the ways and means position which would in turn impair the capacity of General Revenues to finance development expenditure of which Railways also form a part. With the vast expansion of the Railways brought about by the implementation of the First Five Year Plan and that contemplated in the next Plan, the Railway Revenues will also look up in future and the Railway Finances should, therefore, present a better picture.

16. Besides, the annual borrowing rate of the Government of India has been steadily going up since 1952-53 after the temporary fall for 2-3 years. The rate for 1954-55 is 3·17 per cent. and is likely to go beyond 3·18 per cent. in the near future—the rate which was obtaining in 1949-50 when the present rate of dividend of 4 per cent. was fixed. As General Revenues raise the Loan for Railways, the latter enjoy a comparatively preferential rate of interest. If Railways were to float loans in the open market themselves, the rate of interest would be somewhat higher. In fact, the rate of interest on loans floated by statutory corporations although guaranteed by the Government generally, is about half a per cent. higher than the Government's own borrowing rate. The General Tax-payer is the owner and sole shareholder of the Railway Undertaking and as such would expect a return not only to meet the interest obligation on the capital invested but also a reasonable dividend thereon.

17. Taking the above facts into consideration the Committee recommend that the present rate of dividend should remain unaltered for another period of 5 years. However, the Committee feel that in the matter of calculation of the Capital-at-charge and arriving at the total of the dividend payable, some minor adjustments are called for.

(i) Over-capitalisation

18. The Committee observe that as a result of the haphazard growth of the capital structure of the Indian Railways owing to historic reason, an element of over-capitalisation has come to stay.

The total value thereof has been estimated to be Rs. 100 crores approximately by the Railway Board.

A view was expressed that intangible assets and other elements of over-capitalization might be written off to start with. Having regard to the general financial position, the Committee did not agree to this suggestion. The other view was that it may be written down from year to year, if Railway finances permitted, from the surplus left. In the opinion of the Committee, it would not be feasible for the Railways to set up an Amortisation Fund for this purpose in their present financial position. At the same time, the Committee feel that it would be hard upon the Railways to pay a dividend at 4 per cent. on the element of over-capitalisation as well. After a careful consideration of the question, the Committee suggest that the element of over-capitalisation should be precisely assessed by the Railway Board and on that portion of the loan capital, the Railways shall pay the dividend at the rate equivalent to the average borrowing rate charged by the Government of India to the Commercial Departments from year to year.

(ii) **Moratorium on New Lines**

19. The Committee have agreed *vide* para. 28 with the suggestion of the Railway Board that the cost of construction of all new lines, when decided to be constructed, might be debited to the Capital from the very beginning. The Ministry of Railways have formulated an extension programme of building at least 1500 miles of new lines under the Second Five Year Plan. If the Railways were to pay dividend at the rate of 4 per cent. on this additional Capital as well, the dividend during the next five years on these lines alone when most of these lines would not have been opened for traffic and even the few that may be opened would probably just be meeting their working expenses, would be about Rs. 10 crores. The Committee observe from a review of the future financial prospects of the Railway Undertaking that on the basis of the existing levels of fares and freight, it will be difficult for the Undertaking to meet this additional burden, in addition to meeting its other obligations. While the Committee appreciate the reasonableness of the contention of the Railway Board that a new service should be called upon to pay dividend only after it has become remunerative and stabilised its position they consider that it would be unbusinesslike if the General Revenues should be made to forego altogether payment of such a large sum of money, particularly, as it has to meet the interest obligations in any case. At the same time, the Committee feel that with a view to encouraging the Railways to undertake construction of new lines, some concessions are necessary. The Committee, therefore, recom-

mend that the dividend on the Capital-at-charge of these new lines should be computed at a lesser rate *viz.*, the average borrowing rate charged to the Commercial Departments and a moratorium should be granted in respect of the dividend payable on the Capital invested on the new lines during the period of construction and upto the end of the fifth year of their opening for traffic, the deferred amount being repaid from the sixth year onwards in addition to the current dividend out of the net income of the new lines.

20. The Committee now proceed to deal with the other ancillary matters which have a bearing on the needs of the Railways and are essential for maintaining the operational efficiency and earning potential of the Railway Undertaking so as to enable it to continue to pay the dividend at this rate during this period.

Contribution to the Depreciation Reserve Fund

21. The Separation Convention of 1949 laid down;

(i) that the full cost of replacement, including the improvement and inflationary elements in it, should be charged to the Depreciation Reserve Fund;

(ii) that, keeping in view the balance at the credit of the Depreciation Reserve Fund and the arrears in replacements to be overtaken, the rate of contribution to the Fund should be a minimum of Rs. 15 crores a year for the next 5 years; but should the results of operation of the Railways permit additional contribution over and above this minimum, such contribution should be made to the extent necessary and justified; and

(iii) that to secure further strengthening of the Fund, the interest on the Fund balances should be credited to the Fund, instead of taking it as revenue miscellaneous receipts as had been the practice hitherto.

The Committee note that during the five year period covered by the Convention of 1949, the revenue position permitted an additional contribution of Rs. 15 crores being made annually to the Depreciation Reserve Fund, over and above the prescribed minimum of Rs. 15 crores. In addition, a sum of Rs. 3 to 4 crores per annum was also credited to the Fund as interest accruing on the balances. During the period from 1950-51 to 1954-55, against the contribution to the Fund including interest amounting to Rs. 1,69,37 lakhs, the withdrawals from the Fund are estimated at Rs. 1,84,70 lakhs. According to the Railway Board, the total withdrawals from this Fund during the next five years from 1955-56 to 1959-60 are likely to be of the order

of Rs. 250 crores or an average of Rs. 50 crores per annum. Considering the progress of replacement and renewal and the high cost prevailing, the Committee were given to understand that even after the back-log in rehabilitation has been cleared, the total cost of normal replacement of Railway assets, at the present level of prices, would not be less than Rs. 35 crores per annum.

22. Having regard to the expansion of the Railway Undertaking as a result of the implementation of the Five Year Plan and the imperative need to maintain the expanded apparatus at the proper efficient level to fulfil its role in the economic life of the country, the Committee recommend that the annual contribution to the Depreciation Reserve Fund which had been maintained at a level of Rs. 30 crores during the five year period ending the 31st March, 1955 should be raised to Rs. 35 crores during the next quinquennium.

23. Such an increase in the contribution to the Depreciation Reserve Fund is also necessitated by the following change in the system of allocating expenditure on certain items to the Development Fund as suggested by the Railway Board. The Convention Resolution of 1949 laid down that the cost of Passenger Amenity works and Labour Welfare works costing over Rs. 25,000, unremunerative operating improvements in excess of over Rs. 3 lakhs and unremunerative new lines should be debited to the Development Fund. No indication was, however, given as to how the cost of replacement of such assets created originally out of the Development Fund should be financed. The Committee learn that during the first five years the value of such assets amounted to Rs. 42 crores and expenditure of the order of Rs. 85 crores is contemplated during the next five years. One view would be that the Development Fund itself should bear the replacement costs of the above assets. The Committee, however, recognise that the appropriation to Development Fund and the solvency of the Fund are dependent on the availability and the size of the surplus, while the provision for depreciation should be based on the life of the assets, and their replacement on the actual conditions which cannot be deferred, if their earning potential is to be maintained. They, therefore, feel that the replacement of these assets should bear no relationship with the ultimate loss or gain of the Undertaking but should be met out of the Depreciation Reserve Fund.

Extension of the scope of the Development Fund

24. The Committee note that in the coming quinquennial period for which they have fixed the rate of dividend at 4 per cent., a large expenditure is contemplated by the Railways on amenities which will involve an extension of the scope of the Development Fund.

25. At present, the Development Fund bears the cost of (a) all passenger amenity works; (b) all labour welfare works; (c) the excess over Rs. 3 lakhs in the cost of unremunerative operating improvement works, expenditure upto Rs. 3 lakhs being borne by revenue; and (d) new lines and projects which are necessary, but unremunerative.

(a) *Amenities for the Railway Users.*—The Committee considered the suggestion of the Railway Board that the scope of amenities to be provided may also, in future, include all "users of railway transport", such as improvement to goods sheds, loading and unloading platforms, waiting sheds for the trading public, etc. They understand that such an extension of the scope of this Fund will not in any way impair the progress in improving the amenities to passengers for which a provision of Rs. 3 crores per annum was earmarked by the 1949 Convention Committee. They are, therefore, in favour of extending the scope of the Fund as suggested and recommend the continuance of the present practice of earmarking a minimum of Rs. 3 crores per annum for provision of amenities to all users of rail transport which they consider as absolutely essential.

(b) *Staff Welfare Schemes.*—Hitherto, expenditure on quarters, other than for Class IV staff, has been charged to Capital. In fact, all quarters including those for Class IV staff also, used to be charged to Capital in the past, but with the constitution of the Development Fund, the latter class of quarters is being charged to the Fund. It was pointed out by the Railway Board that all quarters, whether for Class IV or other staff, were unremunerative. A review of the rent yield of staff quarters of all classes has shown that even in the past, when the cost of construction was very much lower than the present day cost, the recovery from the staff could not meet the cost of repairs, maintenance and depreciation charges on the quarters. Further, the Committee note that to the extent the cost of staff quarters has been debited to Capital, the Railways are to pay dividend at the rate of 4 per cent. thereon to General Revenues. As the prospect of the rent return contributing towards the payment to General Revenues on the Capital-at-charge pertaining to staff quarters would be very dim in the near future because of the high cost of construction, the Railway Board observed that it was not correct to charge the cost of quarters for Class III staff to Capital. The Committee, however, observed from para. 42 of the Audit Report, Railways, 1951 wherein pointed attention has been drawn to the inadequacy of rent realised for railway quarters. Even in the Audit Report (Railways), 1953 which was presented to Parliament on the 19th May, 1954, it was observed that 'the question regarding the adequacy of the return on the expenditure incurred on residential buildings has not so far been settled by the Railway Board'. According to the

Audit Report also, the return of rent obtained on residential buildings falls short of 4 per cent. for certain classes of quarters. The Committee agree with the Railway Board's suggestion that in accordance with the spirit of the Convention Resolution of 1949, which seeks to arrest the over-capitalisation of the undertaking, the expenditure on Class III staff quarters also should be debited to the Development Fund.

They would, however, recommend that the Railway Board should look into this matter of assessment of rent and ensure that a return of rent more commensurate with the capital cost is obtained on all residential buildings built for Class III Staff.

Operating Improvement Works

26. Operating Improvement Works are partly purely safety works and partly other works to ensure smooth flow of traffic, including line capacity works, improvement to workshops, watering arrangements, etc. The present rate of such expenditure debited to the Development Fund is about Rs. 1·5 crores per annum which includes only a very small amount on account of safety works. The Committee are anxious that the primary amenity which the Railways must provide is that of safety of travel. They, therefore, desire that the expenditure on Safety Works should be given due priority in any allocations of funds from the Development Fund over the next few years.

Allocation of the cost of Unremunerative Operating Improvement Works to the Development Fund

27. The Convention Resolution of 1949 laid down *inter alia* that the expenditure on unremunerative projects for improving operational efficiency costing not more than Rs. 3 lakhs should continue to be charged to revenue, the excess over Rs. 3 lakhs on such projects being charged to Railway Development Fund.

The Railway Board stated that this distinction was unnecessary involving as it did the splitting up of expenditure on works between Development Fund and Revenue for the purpose of allocation. They, therefore, desire that the allocation should be determined as in the case of other works, according to the total outlay expected on each work. The Committee agree with the views expressed by the Railway Board in this behalf and recommend that expenditure on unremunerative operating improvement works costing more than Rs. 3 lakhs each should be charged entirely to Development Fund.

Allocation of cost of New Lines

28. Prior to the 1949 Convention, the construction of unremunerative new lines was also financed out of Loan Capital. As this involved capital overhead liabilities of heavy magnitude, the Railways were

reluctant to undertake the construction of such lines unless the losses were guaranteed by the sponsoring State Governments. This policy was changed under the Convention of 1949 when a Development Fund was created. The practice of obtaining a guarantee from the sponsoring authority was abandoned and it was decided that the cost of unremunerative lines should be charged to the Development Fund initially as a temporary measure, an adjustment being made in the sixth year after the opening of the line, that portion of the cost as will give a return of 4·25 per cent., being transferred to Capital by credit to Development Fund. Usually, a period of five years is allowed for development of traffic. The Railway Board have stated that the number of lines to be constructed which might not pay their way even after the development stage would be few and far between and it would not be a heavy burden on the Railways to pay the contribution to the General Revenues on such lines. It has, therefore, been suggested that the cost of construction of all new lines when decided to be constructed, might be debited to Capital from the very beginning. The Committee observe that there is nothing fundamentally wrong in this proposed allocation. Nor do they see any reversal of the principles laid down by the 1949 convention in this regard, as the Development Fund constituted by them was intended to advance finances for new lines for temporary periods only and ultimately the whole or a substantial portion of the cost was to be transferred to Capital. They, therefore, accept this suggestion.

Financing of Development Fund

29. The Committee have agreed in the preceding paras. to the extension of the scope of the Development Fund whereby certain new items of expenditure which were hitherto debited to revenue and capital would be financed in future from the Development Fund. The Committee were given to understand that in the next five years there would be no funds left to be appropriated to the Development Fund for financing development expenditure if the rate of dividend were maintained at 4 per cent. on the capital-at-charge. They feel that the concession provided in paras. 18 and 19 above and the expectation of buoyant revenues as a result of increased economic activity would set the Railway Finances on an even keel enabling the Railways to divert funds for this purpose. The Committee are, however, anxious that paucity of funds should not be put forward as a plea for staggering expenditure on development purposes or neglecting this important aspect of Railway operation.

30. After considerable discussion the Committee came to the conclusion that in the event of the Development Fund not being in a position to meet the programme of expenditure chargeable to that Fund from its own resources, money should be advanced from Gene-

ral Revenues to the Railways for utilisation on those Projects or Works which are of a developmental nature. Such advances should be treated as Temporary Loans to the Railways and will not be added to the Capital-at-charge on which 4 per cent. dividend is payable annually. The Railways will pay interest on this loan to the General Revenues at the average borrowing rate chargeable to Commercial Departments. It shall, however, be open to the Railways to repay this loan in instalments, if necessary, from accretions to the Development Fund in more prosperous years and thus liquidate the debt and the interest liability thereon.

Loss on Strategic Lines

31. The Convention Committee of 1949 laid down that no dividend on the capital of strategic lines should be payable by Railways to General Revenues. According to the original Resolution of 1924 on the separation of Railway Finance from General Finance, both the interest on the Capital-at-charge and loss in working of Strategic Lines were to be borne by General Revenues, and these were deducted from the contribution in order to arrive at the net amount payable by the Railways to General Revenues each year. Under the present Convention, which prescribes a fixed dividend to be paid to General Revenues, the Capital-at-charge, of the strategic lines only is to be excluded but no allowance is made separately for the loss in working of such lines. The Committee considered the suggestion made by the Railway Board whether the operating loss on strategic lines should not be deducted from the contribution calculated for payment to General Revenues on non-strategic lines. While the Committee are in agreement to a large extent with the principle underlying this suggestion they consider that in view of the fact that the annual loss on such existing lines was insignificant, this point should not be pressed for a decision now but brought up before the next Convention Committee, if the loss on this account is sizeable.

Revision of the test of remunerativeness of a Project

32. The Convention Committee, 1949 considered the question of the criterion to be adopted for determining the remunerativeness of a Project. They felt that the criterion should be linked with the financial obligations which Railways are required to discharge to General Revenues. As the rate of dividend payable to General Revenues was fixed by that Committee at 4 per cent. of the Capital-at-charge, they decided that if the return on a Project was not less than 4·25 per cent. on the capital employed, after making provision for depreciation, operation and maintenance, the project should be considered remunerative. It was urged by the Railway Board that

the margin between the standard of remunerativeness and the obligation to General Revenues was very small and this margin did not possibly cover fluctuations in the estimates, as might often arise due to *bona fide* reasons or due to defective estimation. The Railway Board, therefore, suggested that the margin should not be less than 1 per cent. if it was to cover fluctuation in estimates and leave something to be put by in the reserves. The Committee felt that in the light of their recommendation in the earlier part of the report, in response to the suggestion of the Railway Board that all new lines, when decided to be constructed should be debited to Capital from the very beginning with the moratorium for the first 5 years, the criterion to be adopted becomes a convention and any discussion thereon would be only academic. Nevertheless, it was urged that there would be a practical advantage in fixing the criterion as it would enable the Railway Board to adjust the economics of new lines. The Committee, accepting the suggestion of the Railway Board, recommend that the criterion should be 5 per cent. for classifying a project as remunerative.

Creation of an Amortisation Fund

33. At the instance of the Committee, the Railway Board submitted to them a Memorandum on the desirability, or otherwise, of instituting an Amortisation Fund and the extent to which the Capital-at-charge of the Railways should be written down. It was *inter alia* laid down in the Separation Convention of 1924 that a Reserve Fund should be created for certain specified objects, one of them being the writing down and writing off of capital. Although actually no redemption of Railway Capital has taken place, the principle of amortisation of capital had been reaffirmed from time to time by various Committees and other bodies. Thus during the period of 30 years or so from the commencement of the Separation Convention, the trend of thought had been that when the financial position permitted the Railways to do so, it would be a desirable step to provide for some amortisation of the Capital-at-charge, particularly that part of it which represents no tangible assets as also the other elements of over-capitalisation. While the Committee agree that amortisation would eventually be of benefit to the Railways and the users of Railway transport alike, inasmuch as a redemption of capital will reduce the burden of interest or dividend liability and thus strengthen the financial position of the Railways and would enable them to render service at a lower cost, they cannot escape the conclusion that in view of the estimate that during the next five years *viz.*, 1955-56 to 1959-60, the total Capital-at-charge will increase by about Rs. 300 crores or about Rs. 60 crores per year, amortisation to effect a net decrease in the Capital-at-charge during this period is not a practicable proposition. They agree with the

Railway Board that the time is not yet ripe for amortisation; they would, however, suggest that this question may be taken up at the time of next revision of the Convention, if the financial results of the Railway Undertaking turn out to be very much better in any subsequent year or years than the present anticipations, leaving funds for amortisation of the non-productive and dead Capital.

Revenue Reserve Fund

34. The questions for consideration in connection with this Fund are—

(i) whether the scope of the Revenue Reserve Fund should be extended so as to include amortisation of Capital;

(ii) whether the size of the fund for purposes other than amortisation should be prescribed to ensure the financial stability of the Undertaking.

This Fund was created as part of the scheme of separation of Railway Finance from General Finance with a view "to secure payment of the annual contribution to General Revenues, to provide, if necessary, for arrears of depreciation and for writing down and writing off capital and to strengthen the financial position of Railways in order that the services rendered to the public may be improved and rates may be reduced". The scope of the fund, as originally contemplated, was thus quite comprehensive, the object being to build up, for an Undertaking of the magnitude of the Indian Railways, adequate general reserves not only to meet specific contingent demands *e.g.* shortfall in the contribution to General Revenues and deficit in the working of the Railways, but also for a number of other purposes, like amortisation of the capital, improvement in services to the public etc.

35. The Convention Committee of 1949, while recognising the need for such a fund, felt that its scope should be restricted to maintaining the agreed payments to General Revenues and for making up any deficit in the working of the Railways and did not refer to amortisation of capital. As stated in para. 33, while the Committee are fully cognisant of the fact that in the context of the present ways and means position, the institution of a separate Amortisation Fund in the near future is not possible, nevertheless, they would like to keep open the possibility of any amortisation, particularly, of the element of over-capitalization in the Capital structure, if the actual financial results of the Railway Undertaking turned out to be very much brighter than the present expectations. As, however, there is little likelihood of any credit being given to this Fund at the present level of fares and freight during the next Convention period, the

Committee consider that it will be idle either to prescribe any minimum limit for the balance in this Fund or to extend its scope so as to include amortisation of Capital and this should wait till better days come.

Quinquennial Review of the Separation Convention

36. The Committee considered the period for which the above arrangement should hold. They feel that this period should not be longer than 5 years commencing from the year 1955-56 in the context of the Plan. The Committee hope that at the end of this period, it should be possible for the Railways to make a fairly stable forecast of their revenue position in the light of the expansion of their activities as a result of the implementation of the Plan, so that the rate of dividend could be determined on firm data. They, therefore, recommend that a Parliamentary Committee should review the rate of dividend towards the end of the next quinquennium, and suggest for the years following it, any adjustment considered necessary, in the light of the situation obtaining then.

37. The Committee also considered the suggestion whether preparatory to the next quinquennial revision of the Convention, a general examination of the economic working of the Railways should be undertaken by an *ad hoc* Committee to be set up by the Railway Board or any other agency. The Committee were assured that a close watch over the trends of earnings and expenditure of the Railways was continuously kept and the appointment of a separate *ad hoc* Committee was not necessary.

The Committee came to the conclusion that it would be enough if the Ministry of Railways submitted a review on the working of the Railways during these five years to the next Convention Committee for their consideration when they take up the review of the Convention which the Committee have now recommended.

M. ANANTHASAYANAM AYYANGAR.

NEW DELHI;

The 30th November, 1954.

APPENDIX

Summary of the principal recommendations of the Railway Convention Committee, 1954.

S. No.	Para. of the Report.	Recommendations.
1	2	3
1.	13	It would be advantageous from all points of view to express the rate of dividend in terms of a percentage on the Capital-at-charge and the amount paid annually through a fixed rate of dividend inclusive of the element of interest.
2.	17	The present rate of dividend should remain unaltered for another period of 5 years. However, the Committee feel that in the matter of calculation of the Capital-at-charge and arriving at the total of the dividend payable, some minor adjustments are called for.
3.	18	The element of over-capitalisation should be precisely assessed by the Railway Board and on that portion of the loan capital, the Railways shall pay the dividend at the rate equivalent to the average borrowing rate charged by the Government of India to Commercial Departments from year to year.
4.	19	The dividend on the Capital-at-charge of new lines should be computed at a lesser rate *viz.*, the average borrowing rate charged to Commercial Departments and a moratorium should be granted in respect of the dividend payable on the Capital invested on the new lines during the period of construction and upto the end of the fifth year of their opening for traffic, the deferred amount being repaid from the sixth year onwards in addition to the current dividend out of the net income of the new lines.
5.	22	The annual contribution to the Depreciation Reserve Fund which had been maintained at a level of Rs. 30 crores during the five year period ending the 31st March, 1955 should be raised to Rs. 35 crores during the next quinquennium.
6.	23	The Committee recognise that the appropriation to the Development Fund and the solvency of the Fund are dependent on the availability and the size of the surplus, while the provision for depreciation should be based on the life of the assets, and their replacement on the actual conditions which cannot be deferred, if their earning potential is to be maintained. They, therefore, feel that the replacement of these assets should bear no relationship with the ultimate loss or gain of the Undertaking but should be met out of the Depreciation Reserve Fund.
7.	25(a)	The Committee are in favour of extending the scope of the Development Fund so as to include amenities for all "users of Railway transport", such as improvement to goods sheds, loading and unloading platforms, waiting sheds for the trading public etc., which they consider as absolutely essential and recommend the continuance of the present practice of earmarking a minimum of Rs. 3 crores per annum on this account.

1	2	3
8.	25(b)	The Railway Board should look into the matter of assessment of rent realised for Railway quarters and ensure that a return of rent more commensurate with the capital cost is obtained on all residential buildings built for Class III staff.
9.	26	The Committee are anxious that the primary amenity which the Railways must provide is that of safety of travel. They, therefore, desire that the expenditure on Safety Works should be given due priority in any allocations of funds from the Development Fund over the next few years.
10.	27	The Committee agree with the Railway Board that the distinction of splitting up of expenditure on works between Development Fund and Revenue for the purpose of allocation is unnecessary. The allocation should be determined as in the case of other works according to the total outlay expected on each work. The expenditure on unremunerative operating improvement works costing more than Rs. 3 lakhs each should be charged entirely to Development Fund.
11.	28	The cost of construction of all new lines when decided to be constructed might be debited to Capital from the very beginning.
12.	29	In the event of the Development Fund not being in a position to meet the programme of expenditure chargeable to that Fund from its own resources, money should be advanced from General Revenues to the Railways for utilisation on those Projects or Works which are of a developmental nature. Such advances should be treated as Temporary Loans to the Railways and will not be added to the Capital-at-charge on which 4 per cent. dividend is payable annually. The Railways will pay interest on this loan to General Revenues at the average borrowing rate chargeable to Commercial Departments. It shall, however, be open to the Railways to repay this loan in instalments, if necessary, from accretions to the Development Fund in more prosperous years and thus liquidate the debt and the interest liability thereon.
13.	31	In view of the fact that the annual loss on working of strategic lines is insignificant, the Committee consider that the suggestion made by the Railway Board whether the operating loss on strategic lines should not be deducted from the contribution calculated for payment to General Revenues on non-strategic lines should not be pressed for a decision now, but brought up before the next Convention Committee, if the loss on this account is sizeable.
14.	32	The criterion for classifying a project as remunerative should be 5 per cent.
15.	33	While the Committee agree that amortisation would eventually be of benefit to the Railways and the users of Railway transport alike, they agree with the Railway Board that the time is not yet ripe for amortisation; they would, however, suggest that this question may be taken up at the time of next revision of the Convention.
16.	35	The Committee consider that in the present financial prospects, it will be idle either to prescribe any minimum limit for the balance in the Revenue Reserve Fund or to extend its scope so as to include amortisation of Capital and this should wait till better days come.

1	2	3
17.	36	A Parliamentary Committee should review the rate of dividend towards the end of the next quinquennium and suggest for the years following it, any adjustment considered necessary, in the light of the situation obtaining then.
18.	37	It would be enough if the Ministry of Railways submitted a review on the general working of the Railways during these five years to the next Convention Committee for their consideration.

GIPD—LAD—1088 L S—11-12-54—1,500

सत्यमेव जयते